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CC:CORP:B05 - PLR-103896-02

Date:

July 22, 2002

In Re:

Company =

Sub =

State X =

Trust Y =

M =

Program =

a =

b =

c =

d =

e =

f =

g =

PLR-103896-02

h =

i =

Date A =

Date B =

Date C =

Date D =

Date E =

Date F =

Date G =

Date H =

Date I =

Date J =

Date K =

Dear :

This is in reply to your letter dated January 15, 2002, requesting that we rule on certain federal income tax consequences of a transaction. The information submitted in that request and in subsequent correspondence is substantially as set forth below.

Company is a State X corporation on the accrual method of accounting. Through its subsidiaries, with which it files a consolidated return, Company engages in a variety of industrial pursuits.

By the early Date A, claims were being filed against a number of M manufacturers, including Company. Although many claims against Company were resolved in Date B, Company encountered a significant increase in M claims in Date C.

At the beginning of Date D, approximately a claims were pending against Company. During Date D, approximately b additional claims were filed and

approximately c claims were resolved, leaving a "backlog" of approximately d unresolved claims by the end of Date D. In subsequent years the backlog grew substantially because the number of new claims far exceeded the number of claims resolved. By the end of Date E, the backlog of unresolved claims had grown to approximately e.

In Date F, Company announced the implementation of the Program, which created a private administrative process for resolving present and future M claims against Company, and Sub, a wholly owned subsidiary of Company. The Program was intended to allow claimants to receive prompt payment without incurring the significant delays and uncertainties of litigation. The initial block of claims resolved under the Program consisted of approximately f claims. By Date G, the Program covered approximately g individual claims. In addition, by Date G, there were approximately h M personal injury claims pending against the Company outside of the Program.

During Date H and Date I (through Date J), Company made M-related payments falling within four major categories: (1) settlements in respect of verdicts incurred or claims resolved prior to the implementation of the Program; (2) Program settlements; (3) non-Program settlements covering cases not resolved by the Program; and (4) defense, claims processing and administrative expenses.

Although Company has for many years been cash-flow positive from its core business operations, its cash flow plus insurance payments were not adequate to cover all of its M payment obligations. On Date J (the "Petition Date"), Company and i of its domestic subsidiaries (together "the Debtors") filed voluntary petitions in the United States Bankruptcy Court for the District of State X (the "Bankruptcy Court") for reorganization relief under Chapter 11 of the U.S. Bankruptcy Code.

The Debtors' ultimate objective in filing for relief under Chapter 11 is to propose and have confirmed one or more plans of reorganization for the resolution of outstanding claims against and interests in the Debtors. Pursuant to the Bankruptcy Code, the Debtors initially had the exclusive right to propose a plan of reorganization for 120 days following the Petition Date. Upon the request of Company, the Bankruptcy Court has extended the exclusivity period to Date K. The plan confirmation process will focus on, among other things, the capital structure of the reorganized Company, the forms of value (such as cash, new debt, and/or equity securities) to be distributed to pre-petition creditors, and the allocation of such value among the various classes of creditors.

There are three categories of M claimants that make up the M class of creditors. All claimants and potential claimants allegedly have been exposed to M, although some have not yet manifested symptoms of illness. The groups are: (1) claimants whose claims are covered by Program agreements but have not been fully processed; (2)

claimants who either entered into settlement agreements with Company or asserted pre-petition claims against Company outside of the Program; and (3) future M claimants. The Debtors plan to resolve both pre-petition and future M liabilities pursuant to section 524(g) of the Bankruptcy Code.

Pursuant to section 524(g) of the Bankruptcy Code, the Debtors intend to submit a plan of reorganization that provides for the creation and funding of a section 524(g) trust (the "524(g) Trust" or "Trust Y"). The 524(g) Trust will be administered by independent trustees (the "Trustees") unaffiliated with Company and will remain under the jurisdiction of the Bankruptcy Court after the confirmation of the reorganization plan.

As required under the provisions of the Bankruptcy Code, the Debtors will fund the 524(g) Trust in whole or in part with securities of one or more of the Debtors. In this connection, the Trustees, on behalf of the 524(g) Trust, will take title to at least a majority of the Company's voting stock. In addition, the Debtors may be obligated to make future payments of cash, securities, or other property to the Trustees on behalf of the 524(g) Trust. It is anticipated that the existing equity interests in the Company will be canceled for no or de minimis consideration in connection with confirmation of the plan.

In addition to taking title to at least a majority of Company's stock, the Trustees, on behalf of the 524(g) Trust, will assume all of Company's liabilities for M claims, whether pre-petition or future and whether or not the claimants file a proof of claim in the Company's Chapter 11 case. To that end, all M-related claims against Company will be channeled to the 524(g) Trust and paid pursuant to the terms, provisions and procedures set forth in the 524(g) Trust documents. The sole recourse of a holder of an M-related claim will be against the 524(g) Trust. Therefore, pre-petition and future M claimants will, pursuant to provisions of the Bankruptcy Code, be enjoined from asserting claims against the reorganized Company and against any third parties who have contributed value to or for the benefit of the 524(g) Trust. Instead, the Trustees of the 524(g) Trust will satisfy such claims in accordance with the plan by making distributions from the 524(g) Trust's assets to such claimants in a way intended to pay all such claimants, although they, like other Company creditors, may ultimately receive less than the amount of their claims.

The following representations have been made in connection with the proposed transaction:

- (a) Company will experience an ownership change, as defined in § 382(g)(1) of the Internal Revenue Code, as a result of the implementation of the Debtors' plan or plans of reorganization.
- (b) Company does not plan to make an election under § 382(l)(5)(H) in

respect of the ownership change resulting from the implementation of the Debtors' plan or plans of reorganization.

- (c) Company intends to issue at least 50 percent of the new voting stock of the reorganized Company to the 524(g) Trust pursuant to the Debtors' plan or plans of reorganization. If Company's stock will not be publicly traded after confirmation of the plan, Company will have a qualified appraiser make a qualified appraisal, within the meaning of § 1.468B-3(b) of the Income Tax Regulations, of the fair market value of such newly issued stock within 60 days before or after the effective date of the Debtors' plan or plans of reorganization.
- (d) Once the 524(g) Trust is established, neither Company nor any party related to Company within the meaning of § 468B(d)(3) will own, at any time, directly or indirectly, any beneficial interest in the corpus or income of the 524(g) Trust.
- (e) Once the 524(g) Trust is established pursuant to the Debtors' plan or plans of reorganization, no beneficiary of the 524(g) Trust will be a 5 percent shareholder of Company, within the meaning of § 382(k)(7). For purposes of this representation, a beneficiary's ownership interest in Company will include such person's ownership interest in Company stock held by the 524(g) Trust.
- (f) Company intends to incorporate into its certificate of incorporation transfer restrictions that will prevent Company from undergoing a second ownership change for purposes of § 382 within 2 years after the effective date of the plan.

Section 468B(g) provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax.

Section 1.468B-1(a) of the Income Tax Regulations provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements set forth in § 1.468B-1(c). Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if (1) it is established pursuant to an order, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority; (2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability--(i) under

the Comprehensive Environmental Response, Compensation and Liability Act of 1980; or (ii) arising out of a tort, breach of contract, or violation of law; or (iii) designated by the Commissioner in a revenue ruling or procedure; and (3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Section 1.468B-2(a) provides that a qualified settlement fund is subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under § 1(e).

Section 1.468B-2(b) provides that the term “modified gross income” means gross income, as defined by § 61, computed with certain modifications.

Section 1.468B-2(b)(1) provides that, in general, amounts transferred to the qualified settlement fund by, or on behalf of, a transferor to resolve or satisfy a liability for which the fund is established are excluded from gross income. However, dividends on stock of a transferor (or a related person), interest on debt of a transferor (or a related person), and payments in compensation for late or delayed transfers, are not excluded from gross income.

Payments made in settlement of a lawsuit or potential lawsuits are generally deductible under § 162(a) if the acts that gave rise to the litigation were performed in the ordinary conduct of the taxpayer’s business. See Rev. Rul. 80-211, 1980-2 C.B. 57, and the authorities cited therein.

Section 461(h)(1) provides that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 1.468B-3(c)(1) provides, in general, that for purposes of § 461(h), economic performance occurs with respect to a liability described in § 1.468B-1(c)(2) (determine with regard to § 1.468B-1(f) and (g)) to the extent the transferor makes a transfer to a qualified settlement fund to resolve or satisfy the liability.

Section 1.468B-3(a)(1) provides that a transferor must treat a transfer of property to a qualified settlement fund as a sale or exchange of property for purposes of § 1001(a).

Section 1.468B-3(b)(1)(i) provided that a transferor must obtain a qualified appraisal to support a loss or deduction it claims with respect to a transfer to a qualified settlement fund of nonpublicly traded securities (as defined in § 1.170A-13(c)(7)(ix))

issued by the transferor (or a related person).

Section 1.468B-1(f)(1) provides that except as otherwise provided in paragraph (f)(2) of this section, a liability is not described in paragraph (c)(2) of this section if it is a liability for the provision of services or property, unless the transferor's obligation to provide services or property is extinguished by a transfer or transfers to the fund, account, or trust.

Section 1.468B-2(e) provides that a qualified settlement fund's initial basis in property it receives from a transferor (or from an insurer or other person on behalf of a transferor) is the fair market value of that property on the date of transfer to the fund.

Based solely on the information submitted and on the representations set forth above, it is held as follows:

- (1) Trust Y will qualify as a qualified settlement fund under § 1.468B-1 because the three requirements of that section will be satisfied. First, the establishment of Trust Y must be approved by the Bankruptcy Court, and the trust is subject to the continuing jurisdiction of the Bankruptcy Court. Second, Trust Y will be established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred (i.e., the sale, supply, or production of products containing M) and that has given rise to at least one claim asserting tort liability for personal injury or death. Third, the assets of Trust Y will be segregated from other assets of the transferor (and related persons).
- (2) Trust Y will be subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under § 1(e).
- (3) The transfer of stock of the reorganized Company into Trust Y and the transfer of cash and other assets into Trust Y on behalf of the Company (transferor) to resolve the M liabilities that Trust Y will be created to assume will not constitute gross income to Trust Y, upon confirmation of the plan of reorganization or at a later time, pursuant to § 1.468B-2(b)(1). However, dividends paid on the stock of reorganized Company (or a related person), will not be excluded from the gross income of Trust Y.
- (4) The Company will be entitled to deduct the amount of cash and the fair market value of the stock of the reorganized Company and any other assets that it transfers to Trust Y in the taxable year or years of the transfers, provided, however, that no deduction will be allowed for the

transfer of the reorganized Company stock unless the qualified appraisal requirements of § 1.468B-3(b) are satisfied. Further, the Company must recognize gain or loss on the transfer of non-cash property to Trust Y in an amount equal to the difference between the fair market value of the property on the date of transfer and the adjusted basis of the property in the hands of the Company immediately before the transfer.

- (5) Trust Y's initial basis in all property (other than cash) received by Trust Y from the Company (including stock in the reorganized Company and any other assets) will be the fair market value of such property on the date of transfer pursuant to § 1.468B-2(e).
- (6) The portion of any net operating loss attributable to deductions for M related personal injury claims, such as deductions being generated on the transfer of cash and other property, including the issuance of stock of the reorganized company to Trust Y, will be a specified liability loss as defined in § 172(f)(1)(A) and will be eligible for a 10-year carryback.
- (7) The Company will not have cancellation of indebtedness income nor suffer a reduction of its attributes by operation of § 108(b) because of the discharge, release, and extinguishment of all its obligations for or in respect of M related claims.
- (8) For purposes of applying §§ 382(l)(5)(A) and 382(l)(5)(E)–
 - (a) Trust Y will be considered to receive the M claims from the beneficiaries in a qualified transfer within the meaning of § 1.382-9(d)(5)(ii)(A), and will be considered to have held each M claim for the period it has been held by the transferor beneficiary (including M claims held by beneficiaries not yet identified). If any transferor beneficiary itself received an M claim in a qualified transfer (within the meaning of § 1.382-9(d)(5)), such transferor beneficiary is considered to have held the M claim for the period that it was owned by its transferor.
 - (b) Trust Y will receive the Company stock pursuant to a plan approved by the Court in a Title 11 or similar case as a creditor in the satisfaction of the M claims that are considered to be transferred to it by the beneficiaries.
 - (c) The M claims that will be transferred to Trust Y (including claims of beneficiaries who have not yet been identified) are indebtedness that arose in the ordinary course of the Company's trade or

business within the meaning of §§ 382(l)(5)(E)(ii) and 1.382-9(d)(2)(iv).

- (d) To the extent that the M claims (including claims of beneficiaries not yet identified) have been held by the same beneficial owner (taking into account the qualified transfers in (a) above and any other qualified transfers) for one of the periods specified in § 382(l)(5)(E)(i) or (ii) such claims will be qualified indebtedness.
- (e) To the extent that the M claims are qualified indebtedness, Trust Y will be considered a qualified creditor.

No opinion is expressed as to the tax treatment of this proposed transaction under any other provisions of the Internal Revenue Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be cited or used as precedent.

A copy of this ruling should be attached to the federal income tax returns of the taxpayers involved for the taxable year(s) in which the proposed transaction is consummated.

Pursuant to the power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Charles Whedbee

Charles Whedbee,
Senior Technician Reviewer, Branch 5
Associate Chief Counsel (Corporate)